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The Food Situation

THE rise in grain, meat and dairy prices in the first half of September was a very spectacular affair, and with people deeply concerned over the cost of living the accompanying clamor in the press and public discussion was inevitable. However, the furore added fuel to the rise, and it has done more to confuse than to promote the sober consideration which the food situation needs. Much of the comment not only conveyed an overdrawn impression of the overall food price advance — on September 13th the food component of the Bureau of Labor Statistics wholesale price index was 3 per cent above the peak of October 1946 — but it included predictions, many of them hasty and extravagant, of still higher prices.

Extreme statements as to the plight of consumers and demands for reestablishment of rationing and price controls also helped create an impression of crisis. Finally, the atmosphere has been clouded by largely irrelevant charges respecting "monopoly", "meat packers' profits", and "big business" in general, although nothing is clearer than that the markets in which prices have risen most are precisely those in which competition is freest and greatest.

In such an atmosphere facts tend to be exaggerated, emphasis to be one-sided, and market actions to be violent. Demand was temporarily increased by a scramble to cover requirements or to seek speculative profit, and offerings were temporarily diminished by sellers holding back. But while prices were rising, corrective influences were already at work. The violent advance in grains made feeding of livestock more risky and less profitable, while the rise in meats and dairy products invited consumer resistance. A reminder is in order that the seasonal increase in hog and cattle slaughter already is under way and is expected to provide a 20 per cent increase in meat supplies during the next three months. In the grain markets higher prices and accumulating profits in due course invited selling. As a result market pressures eased, although at the close of the month prices were again moving up.

The World Grain Situation

The questions of public importance to be considered are: what are the food demands on this country; to what extent can they be met; and how can we meet them with minimum disturbance in our markets? Ex-President Hoover in a statement September 21st went to the heart of the food situation. He pointed out that although world production of the bread grains, wheat and rye, outside of Russia in this crop year will be about 4 million tons more than last year, the harvest of coarse grains (corn, oats, barley, etc.) will be 32 million tons smaller. Coarse grains are used primarily for animal feed, and the chief impact of the reduced supply falls nominally upon animals rather than upon people. However,

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bread grains are fed to animals also. Shortage of coarse grains acts as a vacuum, sucking in an abnormally large amount of bread grains for animal feed at the expense of human consumption.

The other major factor is that Western Europe has a larger deficit of bread grains than in the 1946-47 crop year. Europe's 1947 wheat crop is estimated at 250 million bushels (7 million tons) less than last year, 530 million below the prewar average, and the loss is concentrated in Western Europe with the worst spots in Germany, Austria, France, and Denmark. Moreover, drought during August hurt other Western European crops, notably potatoes. Import needs of the deficit countries this year are therefore estimated to be substantially larger than last year, when the exporting countries shipped them 28.4 million tons of grain.

As of August 15 the Department of Agriculture tentatively estimated exportable grain supplies in the surplus producing countries at 29 million tons. Since that date, however, there has been further deterioration in our corn crop, now estimated at only 2.4 billion bushels against 3.3 last year, and in the Canadian wheat crop. Canada's export surplus looks to be around 170 million bushels, almost all committed to Great Britain, as against 240 million exported last season. Even if total shipments should equal last year's, Europe's privation will be greater.

The American Problem

Both humane considerations and self-interest influence the United States to do all in its power toward relieving the European food shortage, but in order to make the maximum contribution it must solve problems of its own. It is blessed with a record wheat crop of over 1,400 million bushels, and except for the short corn crop could spare all the wheat that could be transported and shipped. However, the corn shortage is certain to lead to heavier feeding of wheat to animals. The American people have a record purchasing power; they are consuming 153 pounds of meat per capita as against only 133 before the war; and they are demanding meat of high quality. The prices they are able to pay for meat make it possible for feeders to pay high prices for corn and make wheat an attractive feed.

Hence there is acute competition for the supply. The danger is that an excessive amount will be fed; or, alternatively, that bidding for wheat for export, to divert it from use as feed, will force prices still higher and give another turn to the inflation spiral.

The Cabinet Food Committee has set a goal of 400 million bushels for wheat exports this year, and 70 million for other grains. Last year the wheat figure was also 400 million, but exports of other grains reached 167 million. Allowing 610 million bushels for normal flour and seed requirements, and assuming no use in distilling and an unchanged carryover at the end of the crop year, 400 million bushels of wheat will be available for feed. This is an enormous amount. Usually animals have eaten between 100 and 300 million bushels annually (190 million in 1946-7), the amount varying with fluctuations in grain and livestock price relationships. But in 1942-3 nearly 500 million bushels were fed.

Since the Cabinet's export goal should be considered a minimum, the pressing questions are, whether wheat fed to animals will reach or exceed the 400 million ceiling, and what policies are appropriate to safeguard the export program. Some saving in the food use of wheat might be accomplished and amounts used in mixed feeds could be limited, but the totals saved would be small compared with the amounts animals may consume directly. An allowance of 250 million bushels of wheat for feed would raise the total feed supply per animal to be fed to the prewar average, though it would still be materially below last year. But while this figure is reassuring, it warrants no complacence. For at recent prices a ton of wheat, superior to corn in protein, has been worth less in the markets than a ton of corn. The incentive to feed wheat is obvious.

The Alternatives

On the general premise that wheat feeding to animals should be discouraged there seems to be no disagreement. The way to get the wheat needed for export is to consume less grain-fed and more grass-fed beef and less pork, dairy and poultry products, — all with the objective of lowering prices of grain-fed products relative to prices of grain.

The alternative policies that may be followed, and the advantages and disadvantages of each, seem to be clear. One possibility is to reestablish rationing and price controls, particularly upon meats. Controls would arbitrarily set meat prices at a point where feeding with high-priced grains would be checked, and rationing would be restored to make the price controls work.

Among those who propose this are some whose attachment to the philosophy of government control leads them to take every possible pretext to further it, and whose disinterestedness may be suspected. Others, however, are objective, and are sincerely convinced of the need. What they

seem to suffer from is short memory. They appear to have forgotten that ceiling prices plus subsidies plus premiums paid above ceilings added up to prices nearly as high as those now current, and that people who did not pay the premiums usually did without meat. In fact, meat rationing and price control virtually ended themselves well before President Truman made the end official. The system would certainly work no better now, in the face of the demand represented by the $200 billion of personal incomes (annual rate) which people now receive. Added to these considerations is the practical objection that the organization to establish and administer such a system could not be functioning for many months.

Another course would be to do nothing about the situation and make no effort to influence it. The government agencies would pay for wheat whatever is necessary to reach the export goals, forcing the price as high as needed to discourage feeding and bring the cereal off the farms. The meat markets would be left to themselves. The disadvantage, as noted, is the possibility of a further sharp rise in grain and meat prices and in the food cost of living, the provocation to additional wage demands, and the danger of setting off another turn in the inflation spiral.

The Middle Way

Between these two extremes is a middle way, which, however, can be effective only if the people of the United States are thoroughly informed as to the necessities of the situation and give their fullest cooperation. That is the way of voluntary elimination of waste in food use, and in particular of economy in the use of wheat directly and of meats and livestock products. President Truman has appointed a Citizens' Food Committee, headed by Charles Luckman, president of Lever Brothers Company, and composed of leaders in the food industries, in labor and consuming groups, to formulate a course of action by which this country can make a maximum contribution to getting Europe through the Winter. If this should involve wheatless days and meatless days the country should support them whole-heartedly. They would yield more food for Europe, and lower prices for us.

Some people believe that exhortation and voluntary effort are of little use in accomplishing a purpose of this kind. Their faith in the ability of people to understand and cooperate has become jaded and seems incapable of revival. To be sure, there seems to be ground, at times, for this cynicism. Recently Senator Taft was shamefully insulted and denounced when he stated in effect what we have just suggested, that the solution of our problem is to economize in the consumption of foods needed by people who are far hungrier than we. For that is exactly what his term "eat less" means.

If information as to the rate at which wheat is being fed on the farms, or inability to buy it for export without causing a violent price rise, should indicate the need for such a program, people should be given a chance to make it effective through free voluntary effort. If they will not solve such problems by giving their understanding and cooperation they run the danger of having them solved by controls which would lessen their liberties. The way to protect liberties is to exercise them.

Conflicting Government Policies

The responsibility of the Government is not confined to informing and leading people in food conservation. Its procurement policies exert great influence, and it goes without saying that purchases for export should be handled to exert the least possible pressure on markets. Repetition of the squeeze of last March, when the Government contracted for more wheat in the Southwest than was available, would be deplorable.

Government support policies, which contribute to the strength of food prices, ought to be carefully re-examined. Under the law the Government supported prices of potatoes — the best possible replacement for cereal foods — last year and this. Most of the potatoes it acquired last year were diverted to non-food uses, wasted or destroyed. A few were exported. To lower the cost of the support program, the Department of Agriculture this year reduced potato acreage goals and stipulated that support would be given only to producers who complied with the lower goals. As a result harvested acreage this year will be about 15 per cent smaller and the potato crop in prospect is below normal consumption requirements. The potato policy therefore has turned out to be a mistake of the first magnitude. Yet press reports say that potatoes of good grade, acquired under this year's support program, still are being diverted to alcohol plants despite the sub-normal crop.

The law required the department to extend the support. Hence the law itself is inflationary, and it ought to be reconsidered.

Peanuts and turkeys are other examples. Present low storage stocks of eggs (3.8 million cases) are attributable to heavy government buying — around 10 million cases of shell eggs — to support prices last Spring. Had the excess production of the flush season gone into storage, egg prices

would have been lower then, but also lower now and next Winter. Government stocks of dried and frozen eggs presumably will be shipped abroad to supplement exports of cereals, but more people would be provided with more calories if the cereals fed to poultry could have been shipped instead.

Government officials argue that the support programs are beneficial because they stimulate production, but stimulus to production of animal products which consume cereals is not wanted. The need now is to obtain more of the foods that are cheapest relative to their caloric content, and this means cereals, above all.

All Interested in Inflation Control

Everyone in the United States has a great stake in keeping inflationary forces under control. The longer they are allowed to run on, the greater will become the disparities between prices of various products and incomes of various groups of the population. The terms upon which different producers exchange their goods and services will become more and more inequitable, trade therefore less practicable, and "bust" will follow the "boom".

Meanwhile higher prices will be capitalized into values of land, real property, and equipment. The costs of doing business will be advanced and become more rigid, and the ability to adjust downward and meet changed conditions will be impaired. This is something in which everybody has a vital interest. The need is to work and produce more effectively, consume more economically, and maintain stability in wage rates, to prevent another turn in the spiral while production, competition and economy bring prices back into adjustment.

It should be plain that fighting inflation by indictment of tire manufacturers and Washington real estate brokers, for example, and by denunciation of "big business" and similar measures, is beating the devil around the barn to no purpose. Any pretense that such steps hold an effective solution has been destroyed by the fact that the present rise in living costs, and the danger of further rise, are both attributable mainly to a few foods whose markets are free and competitive. The tactics of anti-trust prosecution and denunciation fail to go to the heart of the inflation problem. It is the immense purchasing power, the money and the spending, that is doing the damage.

Food Industry Profit Margins

We have referred in the preceding article to the accusations of excessive profits in the food industries as a factor in the present high prices of food. Some of these charges have appeared in testimony before the Congressional Joint Committee now holding hearings in various cities to investigate the cause of high prices. An example is the following testimony given last month before the Committee meeting in New York, reported under a front-page newspaper headline — "Super-Profits Key to HCL, Probe is Told" —

> Business and industry were not satisfied with profits as usual. They obtained super profits from inflation which they kept promoting with one unwarranted price increase after another. The giant food corporations had even greater profit increases than business and industry as a whole.

What are the facts? It is true that the earnings of representative companies in the food industries have undergone sharp increases, both in actual dollars and in terms of net worth. But this is not the whole story. It is a well known fact that the volume of business has had a tremendous expansion, which in a free market tends naturally to bring about a sharp increase in total earnings and in return on investment. The picture is not complete, however, until consideration is given to the profit per dollar of sales. This represents the profit margin upon which the company operates and comprises the portion of the total price of the product taken for the services of the processor or distributor.

In the accompanying table we give the average annual profit margins per sales dollar of leading food corporations over a period of years since 1936. These figures are summarized from our annual tabulations covering all major branches of corporate enterprise which have been given in the April issue of this Letter.

Net Profit Margins in Cents per Sales Dollar of Leading Food Corporations

	Food Producing or Processing						Retail
Year	Baking	Dairy Prod.	Meat Pack.	Sugar	Other Food	Total	Grocery Chains
1936	6.6	3.5	1.3	8.5	6.8	2.5	1.5
1937	5.6	2.7	0.7	6.4	5.4	2.1	0.9
1938	6.5	3.1	—0.3	0.6	7.8	2.1	1.1
1939	6.2	3.8	1.2	4.6	8.3	3.3	1.7
1940	5.2	3.2	1.3	8.1	7.5	3.2	1.4
1941	4.6	2.9	1.2	8.6	7.0	2.8	1.4
1942	4.1	2.3	1.2	9.5	6.0	2.5	1.0
1943	3.6	2.2	1.1	5.1	4.3	2.1	1.0
1944	3.1	2.1	0.9	6.1	4.8	2.1	1.0
1945	3.3	2.1	0.9	4.7	3.2	2.0	1.0
1946	6.5	3.2	1.7	6.0	5.1	3.4	1.6
1947 6 mos.	5.8	2.7	—	—	6.8	—	1.5
11-Year Average 1936-46	5.0	2.8	1.0	6.2	6.0	2.6	1.2

Net profit margins, after tax reserves and tax credits, include income from investments and other sources as well as from sales.
— Net deficit.

It will be seen that profit margins of the leading food companies in 1946 and the first half of 1947 were little if any wider than in other years of active business such as 1936-37 or 1940-41, and in many cases were actually narrower, despite

sales now at all-time high levels. Margins were substantially higher in 1946-47, however, than during the war period, when they were depressed below prewar levels by price controls and excess profits taxes.

For the eleven-year period 1936-46, the average net profit margin of these food processing organizations was but 2.6 cents per sales dollar, while that of the grocery chains was but 1.2 cents. Many of the nationally known food processing and merchandising companies handle a huge volume of business; the dollar totals of their earnings run into large figures, yet do not mean large profits per sales dollar.

In the above summary, the number of corporate reports available for each tabulation varied somewhat from year to year, and in 1946 included 18 baking, 15 dairy products, 17 meat packing, 21 sugar, and 38 other food, making a total of 109 food manufacturing, with 17 grocery chains. Figures for the first half of 1947 are limited to a smaller number issuing interim statements, and do not include meat packing, sugar, or certain other food lines in which most companies publish only annual reports.

Other Evidence on Profits

Supporting evidence that the principal cause of the dollar increase in food company earnings was not abnormally wide profit margins, but the great expansion in volume of business, is brought out in a report just prepared by the Congressional Joint Committee's staff for use in connection with the price hearings now being held. Its 68-page report entitled "Food Prices, Production, and Consumption" presents comprehensive factual material and analysis of all the basic factors. After analyzing the financial reports of ten of the largest food processing companies and eight retail distributors, the report makes the following observation:

> This table clearly demonstrates how a relatively small increase in profit per dollar of sales is accentuated in rate of income on net worth. Most of the dollar increase in profits is accounted for by increased dollar volume of business rather than by increased profits per dollar of sales.

In carrying the analysis further, the report gives the changes since prewar in food prices, and in distribution of the various costs between producer and consumer. Price indexes show that from the 1935-39 average to May 1947, retail prices of farm food products rose 85 per cent, wholesale prices rose 102 per cent, and prices received by farmers rose 139 per cent.

Comparison is made between the retail cost of a typical family "market basket" of assorted foods, and the farm values. In 1935-39 the farmer's share averaged 40 per cent of the retail value, but by May 1947 it had risen to 52 per cent. On the other hand, the marketing charges on the "basket", which include all of the labor costs and other expenses for processing, fuel and supplies, maintenance of equipment, packaging, handling, transportation, storage, taxes, insurance, advertising, etc., as well as profits of all processors and distributors, declined from 60 per cent of the retail price to 48 per cent. This substantial lowering of the marketing spread occurred despite the rising trend of wages and costs generally.

It is always in the public interest that each and every one of the elements of cost, including reasonable return on fixed and working capital, should be kept as low as consistent with maintaining prompt, sanitary, and efficient distribution of the nation's food supply, and progressive concerns throughout the food industries are making constant efforts to lower these costs through expenditures for research and investments in improved equipment. The assumption, however, that any material cut in food prices generally might be "absorbed" from the industries' net earnings must take account of the relatively small portion which profit margins represent in the total price of the product, as shown by the figures given above.

The 16-Nation Aid Program

The report of the Paris conference of sixteen nations on a European recovery program, to be presented to the United States in response to the invitation by Secretary Marshall, is an impressive document. Couched in the calm and measured language of the economic expert, it presents both an illuminating survey of Europe's economic position today and the broad outlines of a recovery program characterized by sound principles and recognition of the essential elements of any successful plan for getting Europe back on its feet. Whatever the ultimate outcome, there can be no question as to the importance of this joint European effort to meet the specifications laid down by Secretary Marshall in his historic address at Harvard University last June when he declared that, as a condition of further aid from this country, "there must be some agreement among the countries of Europe as to the requirements of the situation and the part which those countries themselves will take in order to give proper effect to whatever action might be undertaken by this Government."

A Four-Point Recovery Plan

In brief, what the report purposes is to formulate an economic recovery program for the par-

ticipating countries, involving both self-help and outside aid, aimed at achieving reasonable equilibrium by the end of 1951. This recovery program is based on four lines of action:

1. A strong production effort by each of the participating countries.

2. The creation of internal financial stability by better control of government finances, reduction or elimination of Treasury deficits, restriction of Treasury borrowing from the central bank, and suppression so far as possible of other inflationary practices.

3. The maximum cooperation between participating countries in matters of easing trade barriers, coordination of production policies, pooling of power and transport facilities, standardization of equipment, etc.

4. A solution of the problem of the participating countries' trading deficit with the American continent. Involved in this is the attempt to estimate the magnitude and trend of this trading deficit over the period 1948-51, and thus arrive at a tentative figure as to the amount of outside financial aid required.

The report begins with a short description of the character of the European economy, emphasizing its high degree of development, and the interdependence of trade between one European country and another and between Europe and the outside world. It indicates the devastating effects of the war upon this highly complicated structure, but calls attention to the extent of recovery that has been attained. Thus:

> The scale of destruction and disruption of European economic life was far greater than that which Europe had experienced in the First World War. Industrial production in Belgium, France and the Netherlands was reduced to 30 to 40 per cent of prewar and in Italy to only 20 per cent; production of bread grains fell to only two-thirds of prewar; 300,000 freight cars had been destroyed but a total of 2,800,000 freight cars was damaged. The devastated countries had to start again almost from the beginning.
>
> Nevertheless, recovery proceeded well — indeed much faster than after the end of the First World War . . . By the end of 1946 industrial production in Belgium, France and the Netherlands had recovered to 85 to 95 per cent of the prewar level, while Italian industrial production was back to 60 per cent of the prewar level. In the United Kingdom . . . the prewar level of national output had been fully restored. In the Scandinavian countries production was steadily rising.
>
> In the case of agricultural production . . . the beginning of recovery was evident in all countries in 1946.

Unfortunately, this improvement was not sustained. The report records the serious setback sustained in the Winter of 1946-47 and the following Spring, leading up to the rapid depletion of European dollar resources and swift progress towards a new crisis that prompted the Marshall proposal. In explanation of this deplorable turn of events, the report cites the familiar facts about the severe Winter, the food and fuel shortage, crop failures, and the increased cost of primary commodities which Europe had to buy — all valid and weighty reasons, to be sure, though certainly not the whole story, since a great deal must be allowed (it is impossible to say how much) for the consequences of inadequate economic policies.

New Targets for Production

Returning to the recovery program, the first point is the production effort. Here the report maps out an expansion program extending through 1951 described as similar in general scale to that achieved by the United States in the mobilization years 1940 to 1944. "It calls," says the report, "for an unprecedented peacetime effort of work by the whole population of the participating countries."

Recognizing the importance of concentrating upon key commodities and services, the committee of experts sets up the following targets to be reached by 1951:

> 1. Restoration of prewar bread grain and other cereal production, with large increases above prewar in sugar and potatoes, some increases in oils and fats, and as fast an expansion in livestock products as supplies of feeding stuffs will allow.
>
> 2. Increase of coal output to 584 million tons, i.e., 145 million tons above the 1947 level (an increase of one-third) and 30 million tons above the 1938 level.
>
> 3. Expansion of electricity output by nearly 70 billion kilowatt hours, or 40 per cent above 1947 and a growth of generating capacity by 25 billion kilowatts, or two-thirds above prewar.
>
> 4. Development of oil-refining capacity in terms of crude oil throughout by 17 million tons to two and a half times the prewar level.
>
> 5. Increase of crude steel production by 80 per cent above 1947 to a level of 55 million tons or 20 per cent above 1938.
>
> 6. Expansion of inland transport facilities to carry a 25 per cent greater load in 1951 than in 1938.
>
> 7. Restoration of prewar merchant fleets of the participating countries by 1951.
>
> 8. Supply from European production of most of the capital equipment needed for these expansions.

Internal Financial Stability

One of the best sections of the report is that relating to internal financial stability. Absence of such stability has been a prime cause of Europe's difficulties all along, and one of the most hopeful features of the report is the stress laid at this point. Indeed, what is said here might well be required reading for anyone interested in the role of monetary and fiscal policy in promoting general economic welfare.

Declaring that neither production targets nor European cooperation can be accomplished unless the economies of the participating countries are sound and stable, the report notes in all these countries the existence of inflationary pressures "generated by the reciprocal effects of a shortage of consumer goods on the one hand and an increase in money incomes on the other." This growth of money incomes, the report points out, "develops with cumulative force when it is fed by the inflationary financing of budget deficits."

The strength of the inflationary pressure, the report explains —

differs widely from country to country, partly according to the success of efforts which the country makes to resist it and partly according to the circumstances of the country itself. In some countries relative stability of prices and wages has been preserved by drastic domestic policies of reducing purchasing power, controls, and rationing; where there is a serious shortage of food and consumer goods, however, workers cannot spend their earnings to satisfy their normal needs, and the incentive to work is less than in normal times.

In other countries, the report goes on to say, inflation has reached a more advanced stage; "postwar budgets have not been balanced and there has been a continual rise in prices, which inevitably leads to demands for higher money wages." As the spiral develops it leads eventually to distrust of the currency, producing in the end, the committee states, the disastrous situation in which —

food is hoarded or disposed of in the black market; agricultural producers prefer to reduce their sales or not to sell at all because they cannot buy things with the money they obtain. Industrial workers spend much of their time looking for food and goods. People refuse to invest capital in fixed-interest securities and seek to transfer it into gold or foreign exchange; capital held abroad is left there and becomes a hidden private asset which brings no benefit to the nation as a whole.

All this is profoundly true. What, then, do these sixteen nations propose to do about it? The report pledges them to carry out in a "spirit of determination" the measures in fiscal and currency matters, as well as in production, necessary to "restrict forthwith calls on the Bank of Issue and also other inflationary practices." This means control of government expenditures and of the money supply. The report recognizes the importance of prompt action, declaring the year 1948 to be "crucial".

With these objectives attained, the committee predicts a radical change in the situation. Countries, it is asserted, where there is at present a tendency to hoarding and concealment of resources will find their external financial situation improved by the reappearance of those resources now hidden and the return of foreign exchange assets into normal circulation. In general, "the restoration of a healthy economic and monetary situation with appropriate rates of exchange will stimulate production and exports and open new possibilities of foreign investment and commercial credits."

Problem of the Dollar Deficit

But, continues the document, even with these strenuous efforts at self-help, Europe will still need external aid. The following table shows for the four years 1948-51 the estimated combined trading deficit of the sixteen European nations and western Germany with the American continent. Figures are given for trade with the American continent rather than with the United States alone for the reason that in general Canada and Latin America require payments in dollars in order to be in position to satisfy their import needs from the United States.

Deficit With the American Continent of the Participating Countries (Including Their Dependent Territories) and Western Germany 1948-51
(Billions of Dollars)

	1948	1949	1950	1951	Total
U. S. A.	5.64	4.27	3.28	2.62	15.81
Rest of American Continent	1.94	1.82	1.30	0.91	5.97
Total	7.58	6.09	4.58	3.53	21.78
Deficit of dependent territories	0.46	0.26	0.07	—.13*	0.66
Total	8.04	6.35	4.65	3.40	22.44

*Surplus.

It will be seen that for the year 1948 the estimated dollar "gap" exceeds a total of $8 billion, tapering down to something under $3½ billion by 1951. For the entire four years the total is put in excess of $22 billion. Allowing, however, that some $3 billion of European purchases, representing particularly capital equipment, might be financed by the International Bank for Reconstruction and Development and through additional credits other than direct United States aid, the committee calculates that the deficit remaining to be dealt with could be reduced to around $19 billion, spread over the years as follows:

(Billions of Dollars)

	1948	1949	1950	1951	Total
Deficit shown in table above	8.04	6.35	4.65	3.40	22.44
Less equip. assumed to be financed by International Bank, etc.	.92	.89	.72	.60	3.13
	7.12	5.46	3.93	2.80	19.31

Either of these series represents an immense amount of money. No one knows whether they are anywhere near right or not. It depends upon any number of different circumstances. One of the important assumptions entering into the calculations is that the Soviet Union will permit a "substantial and steady" resumption of the flow of eastern European food, feedstuffs, and timber to the western European nations, with the prewar flow of cereals from eastern Europe counted on

to be restored by 1951. Then there are all the uncertainties attendant upon such matters as crop yields, trends of commodity prices, progress in reaching industrial production targets, and the like.

We all know the difficulties of projecting our own federal budget estimates no further than one or two years ahead, and how wide of the mark the estimates often have turned out to be. How much more difficult to project over a four-year period the balance of payments figures of sixteen separate nations, with all the imponderables involved, especially in this world today!

The Kind of Program Needed

All this suggests that the practical procedure would be to organize to deal with the problem from year to year, certainly as far as the critical items of food and fuel are concerned. Reconstruction needs, as the report notes, are largely in the area of the International Bank, already a going enterprise.

On this basis, the subject of immediate concern is the magnitude of the dollar deficit for 1948 and the means by which it might be financed. This deficit, estimated in the table immediately above (after allowance for loans from the International Bank, etc.) at $7.12 billion, calls for careful analysis, not only from the standpoint of supporting data, but also from the standpoint of our budgetary position and our ability to supply additional goods without adding to the inflationary effects upon prices and hence nullifying much of the program.

As to the budget, it is to be noted that the President's revised estimates for the current fiscal year ending next June 30 already provide for direct federal aid for foreign relief and reconstruction amounting to $4.3 billion. Thus, at this rate of federal government spending, the measure of the estimated European deficit of $7.12 billion for calendar 1948 that would call for additional financing is in the neighborhood of $3 billion over and above the *rate* in our present budget. For 1949 the figure would be somewhat over $1 billion beyond the present rate.

Also, it should be noted that meeting European needs does not depend wholly on U. S. Government appropriations, with their consequential increased load on the American taxpayer. European countries as a group still have stocks of officially-owned gold and convertible exchange which might be drawn on in some degree, either directly or by trade and credits between European countries; and there is the possibility of the International Monetary Fund playing a larger role as the stabilization program advances. Also, there are the substantial amounts of privately hoarded and concealed gold and other liquid assets, referred to in the committee report, which would become available in increasing amounts provided the situation develops in a way to encourage holders to put these assets into use.

Certainly, the American public will not be very keen to put up more money on the basis of mere promises, no matter how honestly and sincerely they may be made. They will want to take a look at the program from time to time to see how it is running along. This is the difficulty about entering into any firm commitment on a long-range program of this kind. It is all very well for committees of experts to draw up blueprints calling for "an unprecedented peacetime effort of work by the whole population", and for governments to pledge themselves to carry out fiscal and monetary reforms "in a spirit of determination." The problem is to get the great body of individuals in each country to see the urgency of these matters and to give their wholehearted support in personal effort and sacrifice. In this connection, the following sharp criticism of British Government policy, by *The Economist* (London) of August 30, seems very much to the point:

> Another mouse of restrictions has been brought forth from the Labour mountain. Once again, the public had been led to expect very much more than was imposed on them by Wednesday night's announcement. Once again, the inevitable public reaction will be to conclude that the crisis cannot, after all, be as bad as the Government says it is. For the great mass of the people, the only impact of the economic crisis is to be the loss of two-pennyworth of meat a week, and elaborate care is taken to see that there is no reduction in the supplies available to the canteens and restaurants where they eat. The rest of the restrictions are chosen to fall almost exclusively on those who are not wage-earners. So far as the workers are concerned, the Government are still tinkering with the crisis; it is the middle classes who get the tinker's curse . . .
>
> The first test of a sound policy for today is very simple. Does it reproduce in every family budget and in every business profit-and-loss account a microcosm of the nation's desperate straits, so that individual efforts and initiatives will pull in the same direction as the Government's policy? So far from trying to do that, the Government seems to be desperately anxious to insulate the great mass of the people — who, after all, have nearly three-quarters of the total of net personal incomes — from feeling any impact of the crisis. The feather bed is still the economic symbol. And as a result, for all their protestations to the contrary, the country will be lucky if it does not find itself living on the last vestiges of its stock-in-trade, and if the destocking crisis which occurred in coal last February is not repeated before very long throughout the length and breadth of the economy.

The Gold Question Reemerges

In recent months, questions concerning gold have cropped up again and again in connection with the world's postwar economic difficulties. Early in the Summer the International Monetary Fund issued a statement deprecating the increasing international traffic in gold at premium prices, and recommending to its members that they take action to prevent such transactions which the Fund felt were a source of exchange instability. In August, rumors were widely circulated that the American price of gold was to be raised from $35 to $50 a fine ounce, presumably to meet a "world shortage" of the metal. In September, British Foreign Secretary Bevin offered the surprising view that the United States ought to "redistribute the Fort Knox gold" as a means of "increasing the purchasing power of the devastated areas of the world."

That any dollar depreciation was under discussion or would even be considered was promptly and emphatically denied by responsible American officials. Yet the rumors were widely credited abroad and affected the quoted prices for gold shares, gold, and dollars in a number of foreign markets. Here at home many people have been led to wonder how gold fits into the international financial puzzle and the efforts to put the world back to work.

Only Congress Can Revalue

A good many misapprehensions exist both at home and abroad concerning the present tie of the dollar to gold and what the Fort Knox gold is "doing." The ratio of thirty-five dollars to a fine ounce of gold was originally established January 31, 1934 by Presidential proclamation under the authority of the Gold Reserve Act of 1934. The President held a continuing power to revalue the dollar, within specified limits, up to June 30, 1943, when Congress allowed the power to expire. This action, taken during the Second War Loan drive to encourage people to put their savings in War bonds, excluded any possibility of a revaluation of the dollar without express Congressional sanction.

The position of Congress in favor of a stable dollar was reaffirmed when American membership in the International Monetary Fund and International Bank was approved July 31, 1945. In the Bretton Woods Agreements Act the Congress entrusted to the National Advisory Council, under the direction of the President, power to determine the position the United States should take on many types of questions which might come up in the operation of the Fund and Bank. But Congress reserved to itself power of decision on points of greatest importance. Referring specifically to clauses in the International Monetary Fund's statutes which provide for adjustments of 10 per cent or some other amount in the par value of member country currencies, Congress in the Bretton Woods Agreements Act expressly forbade "the President, or any persons or agency on behalf of the United States" to "propose or agree to any change in the par value of the United States dollar" without Congressional authority.

Nevertheless, rumors that the American price of gold is to be raised keep reappearing. These rumors are fostered by ambiguities in the 1934 Gold Reserve Act which have led people to believe that there could be a depreciation of the dollar *de facto* even though revaluation *de jure* requires action by Congress. For example, under Section 3 of the Gold Reserve Act, a foreign government or central bank desiring to have gold in place of dollars must apply to the Treasury for permission to buy gold. The process of conversion is not quick and automatic. Thus even if the Treasury does not often find reason to object, the special licensing procedure engenders a feeling overseas that the tie of the dollar to gold is a matter of day-by-day review and subject to suspension or change at any time.

The Section 8 "Loophole"

More important, Section 8 of the Gold Reserve Act authorizes the Secretary of the Treasury, with the approval of the President, to buy gold at home or abroad "at such rates and upon such terms and conditions as he may deem most advantageous to the public interest," notwithstanding any contrary provision of law relating to maintenance of parity.

This clause, which has no expiration date, furnishes fuel for the recurrent rumors that the Treasury buying price for gold is to be raised. The practical and political difficulties in the way of gold purchases at high prices by the Treasury are generally overlooked. The question arises as to how the operations could be financed. Buying gold at high prices, the Treasury would soon run out of money. Its bank balances could be replenished by putting the newly-acquired gold into the national currency reserves, getting in return gold certificates which could be deposited with the Federal Reserve Banks. But this would involve losses because no more than $35 – the legally-fixed value – could be taken out in gold certificates for each ounce of gold. It is hardly likely that a Secretary of the Treasury would expect an inflation-conscious Congress to rescue

him by legalizing a higher valuation for gold in the national currency reserves.

In connection with the possible loophole of Section 8, some hold that it has been effectively closed in the statutes of the International Monetary Fund, which provide (Article IV, Section 2) that "no member shall buy gold at a price above par value plus the prescribed margin." Yet it is unfortunate that unsettled points of law, as well as the involved licensing procedure for international gold transactions, provide a basis for the slightest doubt as to the country's gold position. They should both be clarified.

What the Fort Knox Gold Is "Doing"

The use of gold in the American money structure was a good deal simpler to understand a generation ago when the banks held their own reserves and, along with the Treasury Department, undertook to convert gold into dollars or dollars into gold for anyone wishing or needing to make the exchange. The system was modified after 1913 when most of the gold reserves were centralized in the newly-established Federal Reserve Banks, and the latter were given the primary responsibility for maintaining gold convertibility of the dollar. In 1934 the Gold Reserve Act transferred all the gold to the custody of the Treasury. In exchange for their gold the Federal Reserve Banks were given gold certificates. These may be redeemed in gold bullion when gold is needed for export though under the present law redemption for internal circulation is expressly forbidden. Partly for reasons of military security, a large part of the gold reserves was later moved to Fort Knox, Kentucky.

The United States gold stock, currently at a figure of $21.9 billion, along with smaller amounts of silver, provides the foundation for the entire currency and banking system. The gold certificates held by the Federal Reserve Banks, to the amount of $20.7 billion, provide gold cover for the $24½ billion of Federal Reserve notes outstanding and the $140 billion of deposit liabilities of the nation's banking system.

About $200 million of gold is required to be held by the Treasury as reserve for less important classes of paper currency. Gold not specifically serving as currency reserve — the so-called "free" gold held in the Treasury cash working balance — amounts to $1 billion. But this billion — part of the 1934 dollar devaluation "profit" — was appropriated in 1945 to help meet the American contribution to the International Monetary Fund and is held against amounts still owing to the Fund.

No Hocus Pocus Will Help

In a word, the gold reserves provide the anchor of stability to the dollar. This is what the gold at Fort Knox is doing. The United States has no gold free to give away. To "give away" any of the gold it would be necessary first to tax away from the public the money equivalent in order that gold may be released from the reserves. There is no hocus pocus by which the burdens of restoring world order can be borne painlessly.

This statement holds even though there does seem to exist the possibility of depreciating the dollar and "manufacturing" money to give away by writing up the price of gold and the value placed on our gold stock. But this is nothing but a mirage. No responsible citizen today wants to increase indiscriminately the supply of dollars bidding up the prices for American goods. There are already too many dollars, competing for the products of American mills, mines and farms and threatening to unstabilize our economy by pushing prices of commodities in scarce supply through the roof.

Some people maintain that since the price of almost everything else has gone up, the price of gold should be moved up too. But acting on such a principle would set inflation around the circle chasing its own tail. Dollar depreciation would spur the rise in other prices and soon it would become "evident" that another dose of depreciation was necessary to keep the price of gold in line with other prices. How this could end short of complete disaster has never been satisfactorily explained.

A World Scarcity?

Another argument is that there is a world scarcity of gold. The price, it is said, must be raised so that there will be enough to go around. Here there is a danger of getting the cart before the horse. Gold is "scarce" — inevitably so — relative to the vast amounts of currency printed and put into circulation to finance government deficits during and since the war. Gold mining can never match the pace of the printing presses when they are running at top speed.

We are bound to hear talk of gold "scarcities" and gold "maldistribution" until government finances are put in order all around the world and until the people abroad begin to regain confidence in their currencies. In some countries that process is well begun. In others the breakdown of confidence — through links to gold or the dollar — never occurred. In others the breakdown has been so complete — the prewar currency has been so far reduced to worthlessness —

that a fresh start has to be made with a new currency. In still others currencies are overvalued in relationship to gold and the dollar and will have to be adjusted to more realistic levels. This will involve raising the official values of gold and the dollar in the concerned foreign countries. But it is difficult to see how any good could be accomplished by tampering with the denominator in the equation — gold and dollars. On the contrary, any such action would involve a decisive setback to the painfully slow task of rebuilding a stable and enduring financial basis for peace and prosperity.

For that task there is in the world today at least $40 or $45 billion of gold valued at $35 an ounce. Since gold is durable and not readily destructible, and production is always going on, this world supply is greater than ever before in history.

Also noteworthy is the extent of the increase since 1939 or 1941 in the amount of gold owned outside the United States. The United States stock, despite its recent rise, is still $900 million short of recovering from the $2.8 billion decline that took place between October 1941 and November 1945. New production during the war predominantly was added to foreign holdings and hoards.

Private hoards, by individuals seeking security against currency depreciation, have been fed during and since the war by sales to the public from national currency reserves, now generally discontinued, and by a limited flow of newly produced gold. For example, the British and American governments sold gold at high prices in India and the Middle East during the war, partly to obtain the local currencies more cheaply and partly to discourage commodity hoarding. Some foreign central banks have sold gold in their own countries at large premiums over the parity price, for the profits or to bolster confidence in the currency. As in the United States, new gold production of South Africa, Canada and other major gold producing countries is purchased by the Government at legally-fixed prices. The same presumably is true in Soviet Russia. Thus the amount of new gold flowing into the free markets is relatively small, especially now with the general discontinuance of official sales.

While the demand for gold has let down in some markets, it continues unabated in others. Thus what new gold is available is eagerly absorbed. Foreign gold refined in the United States for re-export has been sold for $43 an ounce. The foreign buyer then has to run a gamut of transactions in variously depreciated currencies to recover his investment and make a profit besides. For the much publicized figures of $70 and $80 an ounce paid for gold in the Balkans and the Middle and Far East are in terms of currencies which he can sell only at a heavy discount from their nominal values.

It is the international traffic in private gold, at high prices, that the International Monetary Fund is seeking to suppress. How far the Fund will succeed it is impossible to forecast. But the suppression of the traffic itself will not remedy the basic conditions of mistrust. When those conditions are corrected, as history has demonstrated repeatedly, the traffic itself will tend to disappear and gold will move out of hiding and into the national currency reserves.

Gold for Currency Restabilization

The first essentials in restoration of confidence are a balancing of government accounts, so that currency inflation can be brought to a halt, and a restoration or strengthening of incentives to enterprise and production. Attractive opportunity can help entice hoarded wealth into productive channels, and cut down swollen currency circulation. When a nation has prepared a reasonably secure basis for currency restabilization, and gold is needed to see it over the hump, the metal may be obtained by converting dollars, Swiss francs, or other gold convertible currencies. If not enough "hard money" currencies are available for this and other needs, a loan from the International Bank or through some other agency may produce funds to buy gold.

As a matter of practice, the possession of adequate reserves of dollars or other gold-convertible currencies may forestall the need for gold itself. Dollars tied firmly to gold can provide indirect gold cover for foreign currencies convertible into dollars.

The problem of foreign governments is to achieve financial and currency stability. The problem of America is to protect the stability we already have, to provide help overseas within safe limits, and to keep the dollar stable as a reliable foundation for the reconstruction of the world's financial machinery.

THE NATIONAL CITY BANK OF NEW YORK

Head Office: 55 Wall Street, New York

Condensed Statement of Condition as of September 30, 1947

Including Domestic and Foreign Branches

ASSETS

Cash and Due from Banks	$1,208,876,853.69
United States Government Obligations (Direct or Fully Guaranteed)	2,183,146,029.03
Obligations of Other Federal Agencies	30,529,300.30
State and Municipal Securities	244,767,710.79
Other Securities	78,798,333.53
Loans, Discounts, and Bankers' Acceptances	1,144,278,147.11
Real Estate Loans and Securities	2,955,770.41
Customers' Liability for Acceptances	18,039,850.76
Stock in Federal Reserve Bank	6,900,000.00
Ownership of International Banking Corporation	7,000,000.00
Bank Premises	28,714,292.83
Other Assets	3,409,828.12
Total	$4,957,416,116.57

LIABILITIES

Deposits		$4,622,164,738.31
(Includes U. S. War Loan Deposit $27,896,868.44)		
Liability on Acceptances and Bills	$ 31,397,640.76	
Less: Own Acceptances in Portfolio	12,056,090.90	19,341,549.86
Items in Transit with Branches		5,747,315.29
Reserves for:		
Unearned Discount and Other Unearned Income		5,231,673.67
Interest, Taxes, Other Accrued Expenses, etc.		34,345,336.94
Dividend		2,325,000.00
Capital	$ 77,500,000.00	
Surplus	152,500,000.00	
Undivided Profits	38,260,502.50	268,260,502.50
Total		$4,957,416,116.57

Figures of Foreign Branches are as of September 25, 1947

$273,436,706.00 of United States Government Obligations and $3,396,012.50 of other assets are deposited to secure $206,640,343.53 of Public and Trust Deposits and for other purposes required or permitted by law.

Member Federal Deposit Insurance Corporation

CITY BANK FARMERS TRUST COMPANY

Head Office: 22 William Street, New York

Condensed Statement of Condition as of September 30, 1947

ASSETS

Cash and Due from Banks	$ 27,856,823.27
United States Government Obligations (Direct or Fully Guaranteed)	107,752,302.34
Obligations of Other Federal Agencies	1,073,603.57
State and Municipal Securities	5,432,798.81
Other Securities	100,475.00
Loans and Advances	1,227,878.12
Real Estate Loans and Securities	1,665,299.05
Stock in Federal Reserve Bank	600,000.00
Bank Premises	3,157,493.77
Other Real Estate	114,500.35
Other Assets	2,305,696.42
Total	$151,286,870.70

LIABILITIES

Deposits		$118,579,745.88
(Includes U. S. War Loan Deposit $2,993,655.50)		
Reserves		4,206,130.40
Capital	$10,000,000.00	
Surplus	10,000,000.00	
Undivided Profits	8,500,994.42	28,500,994.42
Total		$151,286,870.70

$4,598,062.14 of United States Government Obligations are deposited to secure the United States War Loan Deposit and for other purposes required or permitted by law.

Member Federal Deposit Insurance Corporation

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